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In the Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. .... and .....

THE GLIDDEN COMPANY
and
UNITED STATES GUARANTEE COMPANY,
Petitioners,

vs.

THE UNITED STATES OF AMERICA.

(Two Actions, Nos. 8652 and 8653, in the Circuit Court and Nos. 18,119 and 18,145 in the District Court.)

PETITIONS FOR WRITS OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

The above named petitioners pray that writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Sixth Circuit, entered in the above cases on April 18, 1941, reversing judgments of the United States District Court for the Northern District of Ohio, Eastern Division. Applications for rehearing were duly filed on May 17, 1941, and on June 25, 1941, were denied by said Circuit Court.

OPINIONS BELOW.

The opinion of the District Court filed September 25, 1938 (R. 62),[1] its opinion filed December 13, 1938 (R. 68), and its opinion filed September 22, 1939 (R. 76), are unreported.

The opinion of the Circuit Court of Appeals (R. 86) is reported in 119 F. (2d) 235.

JURISDICTION.

The applications for rehearing were denied by the Circuit Court of Appeals on June 25, 1941. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

(1) Whether the $6.40-per-proof-gallon penalty ("tax") under Section 900 of the Revenue Act of 1926 (44 Stat. 9; 26 U. S. C. A. Section 245) is the *exclusive* measure of recovery under a permit bond, upon the principal's diversion of denatured alcohol to beverage purposes.

(2) Whether there can be any recovery against either principal or surety upon a surety bond to protect the revenue, after it has been adjudicated that the principal is not liable for any taxes or penalties by reason of the identical acts alleged as breaches of the bond.

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[1] Since the pleadings in both cases are substantially alike, and the cases were treated as one, references are to the record in Case No. 18,145, unless otherwise stated.

STATUTE INVOLVED.

Revenue Act of 1926, c. 27, 44 Stat. 9:

Tax on Distilled Spirits

SEC. 900. Subdivision (a) of section 600 of the Revenue Act of 1918, as amended, is amended to read as follows:

"SEC. 600. (a) There shall be levied and collected on all distilled spirits now in bond or that have been or that may be hereafter produced in or imported into the United States, in lieu of the internal-revenue taxes now imposed thereon by law, an internal-revenue tax at the following rates, to be paid by the distiller or importer when withdrawn, and collected under the provisions of existing law.

"(1) Until January 1, 1927, $2.20 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and

"(2) On and after January 1, 1927, and until January 1, 1928, $1.65 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and

"(3) On and after January 1, 1928, $1.10 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon.

"(4) On and after the enactment of the Revenue Act of 1926, on all distilled spirits which are diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage there shall be levied and collected a tax of $6.40 on each proof gallon or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the person responsible for such diversion. If a tax at the rate of $2.20, $1.65 or $1.10 per proof or wine gallon has been paid upon such distilled spirits a credit of the tax so paid shall be allowed in computing the tax imposed by this paragraph. (U. S. C. A., Title 26, Section 245.)"

STATEMENT.

The two actions are brought upon three bonds given in support of permits issued to The Glidden Company for the withdrawal and use of denatured alcohol in the manufacture of non-beverage products, the material condition of which was as follows:

> "Said principal * * * shall pay for all such denatured alcohol illegally or unlawfully diverted, lost, or unaccounted for in violation of such permit and law and regulations at the rate of $4.50 per wine gallon, and *in addition thereto,* shall pay all *penalties* and fines imposed." (R. 12.)

Though the bonds containing the above condition were given on March 7, 1927, July 20, 1927, and January 19, 1928, respectively, their *form* had been adopted prior to the enactment, in 1926, of the above-quoted statute when, through Congressional oversight, there was a gap in the taxing statute such that a diverter of tax-free alcohol for beverage purposes (not a distiller or importer) was not liable for *any* tax or diversion penalty, and would have escaped scot-free, except for the $4.50-per-wine-gallon stipulation in the permit bond, quoted above.

Despite the plugging of this legislative loophole by the above-quoted Revenue Act of 1926, imposing a penalty (so-called "fax") at the rate of $6.40 per proof gallon (approximately $12.80 per wine gallon) upon the person responsible for the diversion of alcohol for beverage purposes, the old form of bond was continued in use.

The petitions in these actions allege (R. 8 to 29) that between November 6, 1927, and February 1, 1930, The Glidden Company diverted to beverage purposes certain tax-free denatured alcohol withdrawn under permits supported by said bonds, by selling non-beverage products manufactured from such denatured alcohol to persons who, to the alleged knowledge of said principal, intended to "clean" said products and use the alcoholic content for beverage purposes.

The answers (R. 47-61) deny the essential allegations of the petitions, and set forth several affirmative defenses, of which only two will be here considered.

The Second Defense (R. 47-53) is that the bonds are indemnity bonds, to secure the revenue, under which (upon diversion to beverage purposes) only the *actual damages* can be recovered, consisting of such revenues (taxes or penalties) as are collectible (upon diversion) from the principal (consisting here of the $6.40 diversion penalties); and that it was adjudicated in a prior action (*United States v. Glidden,* 78 F. (2d) 639, cert. den. 296 U. S. 652) that, subsequent to the alleged diversions, the principal was exonerated from said penalties by its conviction and fine on a plea of *nolo contendere* and by various other extrinsic circumstances.

The Fourth Defense (R. 53), was that the Commissioner of Internal Revenue was not empowered to exact a bond doing more than indemnifying the government against loss of revenue, consisting of such taxes and penalties as might be payable by the principal (*United States v. Zerbey,* 271 U. S. 332), and was not empowered to impose by a stipulation in the bond, *in addition* to the $6.40-per-proof-gallon diversion penalties imposed by Congress, additional penalties at the rate of $4.50 per wine gallon; and that the bond, though otherwise constituting a valid contract, is therefore unenforceable to the extent of the additional $4.50 penalty imposed by the terms of the bond itself "beyond the requisitions of the statute." (*United States v. Tingey,* 9 U. S. (5 Peters 115, 131) 248.)

After the District Court overruled the government's demurrers to the affirmative defenses the government filed replies (R. 70-74). The District Court thereupon granted defendants' motions for judgments on the pleadings, upon the ground that the replies did not present any substantial issue of fact.

The Circuit Court of Appeals has reversed the judgments and directed a trial upon the merits.

SPECIFICATIONS OF ERROR TO BE URGED.

The Circuit Court of Appeals erred:

1. In upholding as valid a stipulation for the payment of $4.50 per wine gallon *in addition* to the actual damages consisting of the $6.40-per-proof-gallon statutory beverage-diversion penalties.

2. In failing to uphold the dismissal of the actions on the ground that the only revenue recoverable under the bonds as actual damages were the $6.40 statutory penalties from which the principal had been exonerated by the judgment in the prior action, *United States v. Glidden, supra.*

3. In reversing the judgments of the District Court.

REASONS FOR GRANTING THE WRIT.

1. Assuming that the bonds, though of an obsolete and no-longer-appropriate form at the time they were given, were valid contracts, and that, if the principal diverted the alcohol, it became liable, as actual damages, for the *penalties* which were expressly made payable in such event. Those were the exceedingly stiff diversion penalties (so-called "tax") imposed by the 1926 Act at the rate of $6.40 per proof gallon (nearly $12.80 per wine gallon).

But those diversion penalties constituted the *only* revenue recoverable from a non-distiller diverter, and constituted the "*actual damages,*" and the *only* damages, recoverable under the bonds. The bonds are bonds of *indemnity* (not penal bonds) under which *only* the actual damages are recoverable, consisting of those revenues (taxes or penalties) for which the principal would be liable even if there were no bond. (*United States v. Zerbey, supra.*)

United States v. Bornn, 104 F. (2d) 641 (C. C. A. 2d) cert. den. 308 U. S. 606, upheld a recovery, under a similar bond, at the stipulated $4.50-per-wine-gallon rate, because in that case the bond was written and breached *prior* to the

1926 Act, when (by legislative inadvertence) there was *no other liability* upon the diverter except that imposed by the bond itself.

But after the 1926 amendment imposed the $6.40 penalties upon the diverter, the provision for the payment of $4.50 *in addition* to the statutory penalties (expressly payable) was not only obsolete but void and unenforceable.

This Court held in *United States v. Tingey, supra,* that a bond exacted by an official of the government as a condition of engaging in a lawful business or occupation is an involuntary bond, and that conditions therein "beyond the requisitions of the statute" are void and unenforceable.

The purpose of the bonds in suit was to *protect the revenue,* by furnishing surety for the payment, by the principal, of the revenues (here the $6.40 statutory penalties) for which, upon diversion, the principal became liable. The provision in the then-obsolete form of bond for the payment of $4.50 per wine gallon *in addition* to the recoverable revenues (actual damages) was "beyond the requisitions of the statute." The Commissioner went beyond "protecting the revenue" when he attempted to impose a $4.50-per-wine-gallon penalty *on top* of the $6.40-per-proof-gallon penalties imposed by the statute.

The Circuit Court's judgment is therefore in head-on conflict with this Court's holdings in *United States v. Tingey* and *United States v. Zerbey, supra.*

2. From the only recoverable revenues (penalties) for which the principal became liable, if it breached the bond, it has been adjudicated to have been exonerated by subsequent events. (*United States v. Glidden, supra.*)

The government sought by the prior action to recover from the principal all the taxes and penalties for which the principal was alleged to have become liable under Section 900 of the Revenue Act of 1926 by reason of the identical acts alleged in the present actions as breaches of the bonds.

(See the government's petition to this Court in said prior action for a writ of certiorari (pages 5 and 6) and its reply brief (pages 1 and 3).) The prior action was dismissed, and the judgment therein conclusively adjudicated that the principal was not liable either for the penalties or for the basic distiller's tax which the statute merges in the penalty rate.

If the government were to sue the Glidden Company now for the basic distiller's tax otherwise than on these bonds, said prior judgment would be a complete defense and bar. These actions on the bonds may be different causes of action from the prior action cited, but insofar as these actions attempt to use the basic distiller's tax as a measure of damages and liability they attempt to enforce a liability and measure of damages from which the principal defendant has been exonerated.

Under the principle of *United States v. Zerbey, supra,* the bonds are bonds of indemnity, to protect the revenue, and to furnish assurance (surety) of the payment of those revenues (taxes or penalties) for which the *principal* becomes liable by reason of the acts constituting the alleged breaches of the bonds.

The bond itself adds nothing to the liability and creates no liability. It merely furnishes *surety* for the collection of the revenues (here the $6.40 diversion penalties) for which, upon beverage diversion, the *principal* becomes liable.

Since the principal has been exonerated by the prior judgment, there can be no recovery on the bonds. (*Jenkins v. City,* 79 Ill. App. 339.) A surety is not liable upon such an indemnity bond for a liability to which its principal has a complete defense with respect to the alleged measure of damages.

The Circuit Court, therefore, failed to apply correctly the law of *res judicata,* and its judgment *is in conflict* with the very decisions of this Court which are cited in the opinion of the court below on this subject.

CONCLUSION WITH RESPECT TO REASONS FOR THE WRIT.

These are the first of the numerous "alcohol bond cases," which have been or are pending, to reach this Court that involve bonds given under the Revenue Act of 1926 and seek (1) to enforce a penalty (sometimes called "liquidated damages") superimposed by a government official upon penalties fixed by the Congress or (2) to collect the basic distiller's tax as the measure of damages after the principal had been adjudicated in a prior action not to be liable for the penalties into which the Congress merged such distiller's tax.

While these cases have not been tried on their merits, there are no merits to try since the records show complete defenses as a matter of law. In such circumstances both parties and the lower courts should be saved from long futile trials.

Citizens and governmental officers alike should be advised whether governmental officers may add to penalties prescribed by the Congress for the very type of alleged violation of law which is covered by the statute. And the repose and good order of society requires an end to litigation when the liability is once adjudicated.

Respectfully submitted,

H. J. Crawford,
Cleveland, Ohio,

Roger Hinds,
New York, N. Y.,

Frank Harrison,
Cleveland, Ohio,

Attorneys for Petitioners.

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In the Supreme Court of the United States

OCTOBER TERM, 1941

Nos. 641 and 642

THE GLIDDEN COMPANY AND UNITED STATES GUARANTEE COMPANY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions of the District Court (No. 641, R. 122–126, 128–129, 142; No. 642, R. 62–72, 68–69, 76)[1] are not reported. The opinion of the Circuit Court of Appeals (No. 641, R. 152–167; No. 642, R. 86–101) is reported at 119 F. (2d) 235.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on April 18, 1941. (No. 641, R. 151; No. 642, R. 85.) Applications for rehearing were

[1] The cases were heard and decided together and the opinions are the same in both.

filed on May 17, 1941 (No. 641, R. 169; No. 642, R. 103) and were denied June 25, 1941 (No. 641, R. 179; No. 642, R. 113). The petitions for writs of certiorari were filed on September 23, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an adjudication that the diversion tax of $6.40 upon each proof gallon of alcohol illegally diverted was a penalty and its enforcement barred by the prior jeopardy of the taxpayer is *res judicata* of suits by the United States to recover upon bonds given to secure the revenue and obligating the taxpayer and its surety to pay for each gallon diverted at specified rates less than the diversion tax but greater than the basic tax.

2. Whether the Commissioner of Internal Revenue was authorized to issue regulations requiring the execution of the bonds as a condition to obtaining permits to obtain denatured alcohol tax-free, and, if not, whether recovery upon the bonds is precluded for that reason.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 11–16.

STATEMENT

These are suits brought by the United States to recover upon bonds given as a condition to the is-

suance to the principal, The Glidden Company, one of the petitioners herein, of permits for the industrial use of specially denatured alcohol. No. 641 is brought upon two bonds in the respective amounts of $100,000 and $50,000; No. 642 upon one bond in the amount of $70,000. The petitioner United States Guarantee Company is the surety on each of the bonds. The district court granted the petitioners' motions for judgments on the pleadings (No. 641, R. 143; No. 642, R. 77). Upon appeal to the court below the judgments were reversed and the causes remanded for further proceedings consistent with the opinion (No. 641, R. 151; No. 642, R. 85).

The pleadings in both cases are substantially similar and the cases may be treated together. The second amended petitions (No. 641, R. 8–48; No. 642, R. 8–29) filed by the United States allege, in substance, that in 1927, 1928 and 1929 The Glidden Company illegally diverted, for beverage purposes, specified large quantities of denatured alcohol which it had withdrawn tax-free for manufacturing purposes under permits issued to it pursuant to the National Prohibition Act (c. 85, 41 Stat. 305); and that by such illegal diversions and various other acts it violated the condition of the bonds which it and the United States Guarantee Company had executed to the United States in order to secure the permits.

The condition of the bonds for $100,000 and $70,000, respectively, as admitted in petitioners' answers (No. 641, R. 95; No. 642, R. 47), is in the form (Form 1480) specified by Treasury Regulations 61 (Art. 110, Appendix, *infra*, pp. 14–15) and is as follows (No. 641, R. 12; No. 642, R. 12):

> NOW, THEREFORE, the condition of this obligation is such that if there be no material false statement in the application for such permit, and the said principal shall not violate the terms of such permit, and shall transport, store, and use such denatured alcohol in accordance with the law and regulations made pursuant thereto, and shall in all respects fully and faithfully comply with all provisions of law now or hereafter enacted and all regulations promulgated thereunder respecting such transportation, storage, and use, and shall pay for all such denatured alcohol illegally or unlawfully diverted, lost, or unaccounted for in violation of such permit and law and regulations at the rate of $4.50 per wine gallon, and in addition thereto shall pay all penalties and fines imposed, then this obligation to be void; otherwise to remain in full force and virtue.

The condition of the bond for $50,000 (No. 641, R. 26) is identical except that, having been executed later than the other bonds, it provides for a rate of $2, instead of $4.50, per wine gallon in conformity with Form 1480 as amended by

Treasury Regulations 3 (Revised August, 1927, Art. 112, Appendix, *infra,* pp. 15–16).

With respect to each bond the petitions allege two counts, each, in the alternative, seeking recovery in the full amount of the bond. One count alleges that by reason of the unlawful diversions and other violations of the bond the United States suffered damages amounting to more than the amount of the respective bonds in that it lost the basic tax imposed by Section 600 of the Revenue Act of 1918, as amended (Appendix, *infra,* pp. 11–12), of $1.65 per proof gallon in the case of the $100,000 and $70,000 bonds (No. 641, R. 21–22; No. 641, R. 24), and $1.10 per proof gallon in the case of the $50,000 bond (No. 641, R. 44). The other count alleges that by reason of the violations of the bond and of the petitioners' failure to pay the United States in accordance with the provisions of the bond, the United States suffered damages at the rate of $4.50 per wine gallon in the case of the first two bonds (No. 641, R. 24–25; No. 642, R. 29), and at the rate of $2 per wine gallon in the case of the $50,000 bond (No. 641, R. 47–48).

The answers filed by the petitioners deny any unlawful diversions or other violations of the bonds, and allege several affirmative defenses to the counts on each of the bonds (No. 641, R. 95–119; No. 642, R. 47–61). The second and fourth of these defenses are invoked in the petition herein (p. 5)

and will be dealt with in the Argument. Demurrers to the affirmative defenses were overruled by the district court (No. 641, R. 126; No. 642, R. 67). Thereafter the United States replied to the defenses (No. 641, R. 130–140; No. 642, R. 70–74) and the cases were decided, as aforesaid, upon the petitioners' motions for judgments on the pleadings.

ARGUMENT

1. The second of the defenses alleged in petitioners' answers and the principal contention made in the petition herein is, in substance, that the actions are barred by the judgment in *United States* v. *Glidden Company*, 78 F. (2d) 639, certiorari denied 296 U. S. 652. That was a suit by the United States against the Glidden Company and another to recover, not upon the bonds, but the tax of $6.40 per proof gallon on each gallon diverted for beverage purposes imposed by Section 600 (a) (4) of the Revenue Act of 1918, as amended by the Revenue Act of 1926 (Appendix, *infra*, pp. 11–12). The defendants filed an answer alleging, *inter alia*, that the tax sought to be collected was a penalty and that therefore, under the double jeopardy clause and the Willis Campbell Act (42 Stat. 222), the suit was barred by the prior indictment, conviction, and punishment of The Glidden Company for conspiring with others to commit the same illegal diversions as those involved in the tax suit. The Gov-

ernment's demurrer to this and other affirmative defenses was overruled by the district court (8 F. Supp. 177). The Government having rested upon its demurrer (78 F. (2d) 639, 640), a judgment was entered for the defendants and, on appeal, was affirmed by the court below, the court considering only the defense of double jeopardy and holding that it was valid.

The petitioners contend (Pet. 6–8) that The Glidden Company's exoneration from the diversion "penalties" of $6.40 per proof gallon is *res judicata* of the instant suits for the reasons that the bonds are indemnity bonds under which the United States is entitled to recover only actual damages suffered by it and that the only such damages suffered by it were the loss of the aforesaid "penalties." However, the court below held and it is well settled that the bonds were designed to secure the collection of the basic tax, as well as the collection of other revenues, and that they are enforcible as contracts notwithstanding that the principal is not subject to the basic tax because not a distiller or importer and, indeed, notwithstanding that collection of the tax is barred by the statute of limitations or some other obstacle. *United States* v. *Bornn*, 104 F. (2d) 641 (C. C. A.

[2] The petitioners (Pet. 6–7) seek to distinguish the decision in the *Bornn* case, *supra*, on the ground that the bonds there were executed and breached prior to the Revenue Act of 1926 when the diverter was subject to no liability for taxes or penalties. However, the bonds were in the same form

2),[2] certiorari denied *sub. nom. Bornn* v. *United States* and *Royal Indemnity Co.* v. *United States*, 308 U. S. 606; *United States* v. *Frost*, 80 F. (2d) 341 (C. C. A. 5); *United States* v. *Stein*, 119 F. (2d) 677, 679 (C. C. A. 3), certiorari denied, No. 524, present Term; *United States* v. *Van Schaack Bros. Chemical Works*, 33 F. Supp. 822 (D. C. N. D. Ill.). See *United States* v. *John Barth Co.*, 279 U. S. 370, 375; *Gulf States Steel Co.* v. *United States*, 287 U. S. 32.

The foregoing decisions likewise establish that the rate of $4.50 or $2 per wine gallon specified in the bonds is reasonable and does not render the bonds penal.[3] Hence it is clear that no question of double jeopardy is presented. *Helvering* v. *Mitchell*, 303 U. S. 391.

(Form 1480) as those here involved and the opinion contains no intimation that the bonds would have been construed differently if the principal had been otherwise liable. In the *Stein* and *Van Schaak Bros.* cases, *supra*, the *Bornn* case was followed though the bonds were executed and violated subsequent to 1926.

In *United States* v. *Zerbey*, 271 U. S. 332, cited by petitioners (Pet. 5, 6, 7, 8), the bond was a general compliance bond which, unlike those here, specified no definite rate of liquidated damages. Hence that case is inapplicable. See *Clark* v. *Barnard*, 108 U. S. 436; *United States* v. *Dieckerhoff*, 202 U. S. 302.

[3] One wine gallon of specially denatured alcohol of the formula here involved equals approximately 1.90 proof gallons. Accordingly, the rates specified in the bonds were slightly higher than the basic tax rates applicable during the corresponding periods, but lower than the diversion tax or penalty rate of $6.40 per proof gallon.

2. The fourth defense alleged in petitioners' answers, also invoked herein, is that the Commissioner had no authority to issue the regulations requiring the bonds because the bonds imposed a penalty of $4.50 or $2.00 per wine gallon in addition to the $6.40 per proof gallon penalty imposed by statute. We may pass the question whether this contention, even if sound, would defeat a recovery. Cf. *United States* v. *Bornn, supra,* 646. For, as already shown, the bonds were remedial, not punitive. Moreover, since the statutory tax or penalty was not collected, there is no occasion to consider whether, if it had been, the stipulation of the bonds could be enforced. The National Prohibition Act (Tit. II, Sec. 6, Tit. III, Sec. 13, Appendix, *infra,* pp. 12–13) authorized the Commissioner to issue regulations requiring bonds, as did the Denatured Alcohol Act of 1906 (Appendix, *infra,* pp. 13–14), and the form here involved has been approved by the courts "as if Congress had itself determined" it. *United States* v. *Bornn, supra,* 646; and other cases, *supra.*

CONCLUSION

The cases were correctly decided by the Circuit Court of Appeals and no conflict or question of general importance is presented. Moreover, contrary to petitioners' assertion (Pet. 9), these are not the first cases to reach this Court involving the enforcement of the stipulation contained in

Form 1480 bonds given subsequent to the Revenue Act of 1926, since the bond in *Stein* v. *United States, supra,* was of the same character. The petition for writs of certiorari therefore should be denied.

Respectfully submitted,

CHARLES FAHY,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
FREDERIC G. RITA,
Special Assistants to the Attorney General.
H. G. INGRAHAM,
Attorney.

OCTOBER 1941.

APPENDIX

Revenue Act of 1926, 44 Stat. 9:

SEC. 900. Subdivision (a) of section 600 of the Revenue Act of 1918, as amended, is amended to read as follows:

"SEC. 600. (a) There shall be levied and collected on all distilled spirits now in bond or that have been or that may be hereafter produced in or imported into the United States, in lieu of the internal-revenue taxes now imposed thereon by law, an internal-revenue tax at the following rates, to be paid by the distiller or importer when withdrawn, and collected under the provisions of existing law:

"(1) Until January 1, 1927, $2.20 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon;

"(2) On and after January 1, 1927, and until January 1, 1928, $1.65 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and

"(3) On and after January 1, 1928, $1.10 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon.

"(4) On and after the enactment of the Revenue Act of 1926, on all distilled spirits

which are diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage there shall be levied and collected a tax of $6.40 on each proof gallon or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the person responsible for such diversion. If a tax at the rate of $2.20, $1.65, or $1.10 per proof or wine gallon has been paid upon such distilled spirits a credit of the tax so paid shall be allowed in computing the tax imposed by this paragraph."

* * * * *

(U. S. C., Title 26, Secs. 1150, 1275.)

NATIONAL PROHIBITION ACT, 41 Stat. 305:

TITLE II

SEC. 6. No one shall manufacture, sell, purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do, * * *

* * * * *

The commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title. In the event of the refusal by the commissioner of any application for a permit, the applicant may have a review of his decision before a court of equity in the manner provided in section 5 hereof.

* * * * *

(U. S. C., Title 27, Sec. 16.)

TITLE III

SEC. 13. The commissioner shall from time to time issue regulations respecting the establishment, bonding, and operation of industrial alcohol plants, denaturing plants, and bonded warehouses authorized herein, and the distribution, sale, export, and use of alcohol which may be necessary, advisable, or proper, to secure the revenue, to prevent diversion of the alcohol to illegal uses, and to place the nonbeverage alcohol industry and other industries using such alcohol as a chemical raw material or for other lawful purpose upon the highest possible plane of scientific and commercial efficiency consistent with the interests of the Government, and which shall insure an ample supply of such alcohol and promote its use in scientific research and the development of fuels, dyes, and other lawful products.

Denatured Alcohol Act of 1906, 34 Stat. 217:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That from and after January first, nineteen hundred and seven, domestic alcohol of such degree of proof as may be prescribed by the Commissioner of Internal Revenue, and approved by the Secretary of the Treasury, may be withdrawn from bond without the payment of internal-revenue tax, for use in the arts and industries, and for fuel, light, and power, provided said alcohol shall have been mixed in the presence and under the direction of an authorized Government officer, after withdrawal from the distillery warehouse, with methyl alcohol or other denaturing material or materials, or admix-

ture of the same, suitable to the use for which the alcohol is withdrawn, but which destroys its character as a beverage and renders it unfit for liquid medicinal purposes; such denaturing to be done upon the application of any registered distillery in denaturing bonded warehouses specially designated or set apart for denaturing purposes only, and under conditions prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

The character and quantity of the said denaturing material and the conditions upon which said alcohol may be withdrawn free of tax shall be prescribed by the Commissioner of Internal Revenue, who shall, with the approval of the Secretary of the Treasury, make all necessary regulations for carrying into effect the provisions of this Act.

Distillers, manufacturers, dealers and all other persons furnishing, handling or using alcohol withdrawn from bond under the provisions of this Act shall keep such books and records, execute such bonds and render such returns as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation require. Such books and records shall be open at all times to the inspection of any internal-revenue officer or agent.

* * * * *

(U. S. C., Title 26, Sec. 1320.)

Treasury Regulations 61 (Revised July, 1925):

ART. 110. A manufacturer desiring to use specially denatured alcohol for manufacturing purposes must file application for permit on Form 1479, in duplicate, with the Federal prohibition administrator of the

district in which the applicant proposes to conduct his business. * * *

* * * * *

Bond, Form 1480, must be filed by the applicant, in duplicate. In case of the approval of the application, one copy of the bond will be retained by the administrator and one forwarded to the commissioner.

The penal sum of the bond shall in no case be less than $500, or more than $100,000, and shall be graduated in accordance with the quantity of alcohol on hand, in transit, or unaccounted for in each 30-day period.

* * * * *

Existing bonds, Form 582A, may be continued where the penal sum is sufficient to cover the estimated quantity, and all new bonds will be executed on Form 1480. Such bonds shall continue in force until canceled or revoked. In the event of any change in location of the premises the consent in writing thereto of the sureties must be obtained in duplicate and a copy attached to both the original and duplicate bonds.

Manufacturers shall file bonds amply sufficient to cover their needs, and under no circumstances will they be permitted to purchase or receive specially denatured alcohol in excess of the quantity named in the application. * * * Failure to observe this requirement will be regarded as sufficient cause for the revocation of the manufacturer's permit.

Treasury Regulations 3 (Revised August, 1927):

ART. 112. A manufacturer desiring to use specially denatured alcohol for manufacturing purposes must file application for permit on Form 1479, in duplicate, with the admin-

istrator of the district in which the applicant proposes to conduct his business. * * *

* * * * *

Bond, Form 1480, must be filed by the applicant in duplicate. In case of the approval of the application the original bond will be retained by the administrator and the duplicate forwarded to the commissioner.

The penal sum of the bond shall in no case be less than $500, or more than $50,000, and shall be graduated in accordance with the quantity of alcohol on hand, in transit, or unaccounted for in each 30-day period.

* * * * *

Where the quantity of alcohol involved is more than 5 wine gallons, but not more than 250 wine gallons, the penal sum of the bond shall be not less than $500. Where the quantity approved exceeds 250 wine gallons but does not exceed 500 wine gallons the penal sum shall be not less than $1,000. In the event of approval of larger quantities than 500 wine gallons, the penal sum will be computed at the rate of $2 for each wine gallon authorized to be withdrawn. Provided, that bonds given for larger quantities than 500 wine gallons must be in multiples of $1,000.

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. 641 and 642.

THE GLIDDEN COMPANY
and
UNITED STATES GUARANTEE COMPANY,
Petitioners,

vs.

THE UNITED STATES OF AMERICA.

(Two Actions, Nos. 8652 and 8653, in the Circuit Court and Nos. 18,119 and 18,145 in the District Court.)

REPLY BRIEF FOR PETITIONERS.

H. J. Crawford,
Cleveland, Ohio,

Roger Hinds,
New York, N. Y.,

Frank Harrison,
Cleveland, Ohio,
Attorneys for Petitioners.

The Gates Legal Publishing Co., Cleveland, Ohio

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REPLY BRIEF FOR PETITIONERS.

Government's Misleading Statement of Questions.

The petitioners have not contended either (1) that the prior judgment is *res judicata* of the claim for recovery on the bonds respectively of $4.50 or $2.00 per wine gallon if and as primary covenants for liquidated damages, or (2) that the Commissioner of Internal Revenue lacked authority to issue regulations requiring the execution of bonds to secure compliance with permits to obtain denatured alcohol tax-free for industrial purposes and payment of legally collectible diversion taxes, penalties and fines.

Those are *straw-man* "questions presented" and answered in the opposing brief in lieu of an answer to the *actual* "questions presented" as stated in the petitions for writs of certiorari (p. 2).

Res Judicata Affecting the Government's "First" Counts.

The petitioners plead the former case (*United States v. Glidden Co., et al.,* 78 F. (2d) 639, cert. den. 296 U. S. 652) as *res judicata* with respect both to the government's "first" counts to collect the basic distiller's tax and also its "second" counts to enforce the alleged liquidated damage clause if, but only if, construed as a unit limit of indemnity clause instead of as a liquidated damage clause.

Perhaps the petitioners should understand that the government has abandoned its said "first" counts and is willing to have them stricken from its amended petitions. If not, the plea of *res judicata* is important in the first instance in connection with those counts and the authorities cited in the government's brief at pages 7 and 8 are not only not on the point but hold contrary to the government's claim in those counts. (See especially *United States v. Bornn,* 104 F. (2d) 641, at p. 647, cert. den. 308 U. S. 606; and *United States v. Van Schaack Bros. Chem. Works, Inc.,* 33 F. Supp. 822, syl. 4.)

The judgment in the prior *Glidden* case, cited above, adjudicated that the principal defendant herein was not liable either for the diversion penalties or the basic distiller's taxes by reason of the identical alleged diversions now charged in these suits on the bonds. (See the record in said prior case, particularly the pleadings and journal entries and the government's petition for writ of certiorari and reply brief thereon, said petition pages 5 and 6 and said reply brief pages 1 and 3, as the Court may do under *Debearn v. Safe Deposit & Trust Co.,* 233 U. S. 24 and *Oklahoma v. Texas,* 256 U. S. 70, 88.)

The So-Called Liquidated Damage Clause was Invalid.

Now, in the "second" counts on each of the several bonds in the pending cases, the government seeks to hold the same principal and its surety liable on the bonds, heretofore conceded and held to be bonds of indemnity, under a clause claimed to be a liquidation of the liability for the same tax (as aforesaid, not levied or chargeable against such principal) on the same alcohol as to which the principal defendant was exonerated in said prior case.

As of the period when the bond form was prepared and adopted and with respect to bonds issued before the Revenue Act of 1926, it was held in *United States v. Bornn, supra,* that the $4.50 per wine gallon clause was enforcible as a liquidation of the basic distiller's tax rate of **$2.20** per proof gallon which was current at the time the bonds in that case were given (notwithstanding it was liquidation of a tax for which the principal was not liable!). Prior to the 1926 amendment a non-distiller-diverter was (by legislative oversight) not liable for either the basic taxes or the diversion penalties, and except for the $4.50 unit penalty in the bond form would have escaped scot-free. That legislative oversight was remedied by the 1926 amendment to the Revenue Act, so that the principal, upon diversion, became liable for the heavy $6.40 per proof gallon (about $12.80 per wine gallon) penalties and the old pre-1926 form of bond became obsolete insofar as it required the payment of $4.50 per wine gallon *in addition* to the 1926 statutory penalties of $6.40 per proof gallon. The latter then became the exclusive liability of a non-distiller-diverter, and the actual damages recoverable under the bonds as well, except for occurrences subsequent to the alleged diversions which in the *Glidden* cases exonerated the principal from such liability.

After the Revenue Act of 1926 the $4.50 and $2.00 unit bond provisions were inadvertent, unenforcible attempts to

superimpose a stipulated penalty on top of the actual statutory penalty. After the 1926 Act the bonds could not be of the character considered in *United States v. Frost,* 80 F. (2d) 341 and other primary or forfeiture bond cases cited by the government. What right or power did the executive department have to fix a lesser rate to be collected either in addition to or without regard to the collectibility of the amount fixed by the Congress? The Congress had preempted the field of taxes, penalties and liquidated damages assessable against a manufacturer other than a distiller.

The government does not attempt to distinguish the case of *United States v. Tingey,* 9 U. S. (5 Peters, 115, 131) 248, which the petitioners cited in their original brief. The fact that the government has not collected the statutory penalty of $6.40 per proof gallon is not a distinction of any character. The Commissioner either had or did not have power and authority to add to or detract from the penalty and liquidated damages prescribed by the Congress and, if he did not have such power and right, collateral circumstances with respect to collection or non-collection of the amount fixed by the Congress are irrelevant.

It is well settled, and conceded, that these bonds are bonds of indemnity to secure the revenue, and when the Congress prescribes the taxes or penalties, or both, which are recoverable from the principal, in the event of breach, those statutory taxes and penalties are the actual damages, and the measure, and the exclusive measure, of the recovery under the bonds. (*United States v. Zerbey,* 271 U. S. 332.)

In *United States v. Stein,* 119 F. (2d) 677, cert. den. No. 524 present term, and *United States v. Bornn, supra,* it does not appear from the reports that there had been any prior judgment exonerating the principal defendant or that the points now raised by the petitioners in the pending cases were presented or considered.

The $4.50 and $2.00 unit clauses fail as enforcible liquidated damage provisions, not because that particular question is *res judicata* (respondent's straw-man), but because *a contract penalty cannot be super-imposed on or substituted for statutory penalties.*

Res Judicata Affecting the Government's "Second" Counts.

The prior judgment, of course, did not adjudicate anything about recovery at the $4.50 or $2.00 rates per wine gallon specified in the so-called liquidated damage clauses of the bonds, because the bonds were not considered, or even mentioned, in the prior suit.

In the *Van Schaack* case, *supra,* the current basic distiller's tax rate was $1.65 or $1.10 per proof gallon, as in the pending *Glidden* cases, and the court held that the $4.50 bond clause was arbitrary, excessive and beyond the power of the Commissioner of Internal Revenue but, inconsistently with its decision in the same opinion that industrial manufacturers were not liable for basic distiller's taxes, that damages at such basic distiller's tax rates could be collected under the clause *as a unit limit of indemnity* rather than as a liquidated damage provision.

If the government should attempt (inconsistently) to change the theory of its "second" counts to that of the court in the *Van Schaack* case, it is important to note: (1st) That the Commissioner lacked power to fix a lesser unit limit of indemnity than $6.40 per proof gallon for the same reasons given hereinbefore; (2nd) That he did not purport to fix any other limit of indemnity than the lump sum limits of the bonds; (3rd) That if the clause is only a unit limit of indemnity the basic distiller's taxes cannot be collected under it for the reason that the bond was not worded or given to secure taxes levied on others than the principal; and (4th) That in the pending *Glidden* cases *the principal*

defendant has been exonerated by the judgment in the prior case from that measure of damages even if it were otherwise collectible under the clause as a unit limit of indemnity.

Respectfully submitted,

H. J. Crawford,
Roger Hinds,
Frank Harrison,

Counsel for Petitioners.

Rec'd.